Supreme Court, U. S.
FILED
DEC 19 1979
MICHAEL RODAK, JR., CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1979

**No. 79-829**

FIRST JERSEY SECURITIES, INC., a corporation of the State of New Jersey; ROBERT E. BRENNAN; JOSEPH GALLIGAN; JACK MONDEL; CHARLES OEHLERT; JOHN DELL; MICHAEL ZUDONYI; and ANTHONY NADINO,

*Petitioners,*

*v.*

HONORABLE VINCENT P. BIUNNO, Judge, United States District Court, Nominal Respondent,

(GEORGE J. BERGEN, individually and in his official capacity; and NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., a corporation of the State of Delaware, Real Parties in Interest),

*Respondents.*

**On Petition for Writ of Certiorari to the Unted States Court of Appeals for the Third Circuit**

## BRIEF OF RESPONDENTS GEORGE J. BERGEN AND NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. IN OPPOSITION

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December, 1979

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Respondents/Real Parties-in-Interest George J. Bergen and National Association of Securities Dealers, Inc. respectfully pray that the Petition for Writ of Certiorari be denied.

## Opinion Below

The opinion of the United States Court of Appeals for the Third Circuit is reported at 605 F.2d 690 and appears within Petitioners' Appendix E, p. 36a *et seq.* The opinion of the United States District Court for the District of New Jersey, not yet reported, appears at Petitioners' Appendix C, p. 5a *et seq.*

## Questions Presented

1. Whether the Writ of Mandamus issued by the United States Court of Appeals for the Third Circuit was appropriate to correct the district court's clear and substantial intrusion into the conduct of a pending NASD proceeding.

2. Did the district court herein exceed its authority by conditionally denying injunctive relief against Respondents upon eight "assumptions" of Respondents' future conduct and by simultaneously retaining jurisdiction to monitor Respondents' conduct and afford a forum for Petitioners if the "assumptions" were not met.

3. Did the district court herein abuse its discretion by failing to dismiss the action in deference to the administrative and judicial review processes established by Congress?

## Statement of the Case

Respondents submit a Statement of the Case because of misstatements and serious omissions in the Petition for a Writ of Certiorari. Specifically, the Petition repeatedly asserts as "facts" the allegations made by Petitioners in the district court. These assertions plus the further characterization of many claims as "uncontroverted" simply ignore the numerous and substantial opposing affidavits filed in the district court and incorporated into its record.



Respondent National Association of Securities Dealers, Inc. ("NASD") is a national securities association registered with the Securities Exchange Commission ("SEC") under the Maloney Act, 15 U.S.C. §78o-3, which amended the Securities Exchange Act of 1934, 15 U.S.C. §§78a *et seq.* NASD's purpose is to provide for self-regulation of the over-the-counter securities markets. It is charged by federal statute to promulgate standards of conduct for its members and to discipline those of its members who fail to conform to the standards which have been prescribed.

Respondent George J. Bergen ("Bergen") is a vice president of NASD and is the Director of NASD District 12, which governs New York City and the surrounding area.

Petitioner First Jersey Securities, Inc. ("First Jersey") is a broker and dealer in securities registered with the SEC and is a member of the NASD. The other petitioners are all officers or employees of First Jersey and, as such, are required to be and are registered with the NASD.

In November of 1977, NASD staff examiners inspecting the books and records of First Jersey found unusual patterns of sporadic, high volume trading in a few low priced over-the-counter stocks. The examiners prepared schedules of market transactions which revealed patterns of market domination and price manipulation used to perpetrate a massive fraud on First Jersey's public customers. The schedules showed that different branch offices

of First Jersey would simultaneously engage in conflicting customer transactions in the same stocks and in extraordinary high volume. Customers in one branch office, for example, would sell stock at $3.00 per share to First Jersey's trading account while, simultaneously, customers of another branch office, sufficiently distant from the first, were sold the same stock at $4.00 per share. The shares sold by customers of the first branch office became the shares purchased by customers of the second branch office.

Subsequent inquiry by NASD staff of some former First Jersey salesmen confirmed that the short bursts of trading activity were limited to selected branch offices and were *not* the coincidental result of independent and honest investment decisions by sales representatives or their public customers. Instead, the transactions were the result of premeditated, coordinated short-term campaigns. On numerous occasions, First Jersey personnel simultaneously solicited massive sales by one branch office's customers of a security and massive purchases of the same security by customers of another branch. The "crossing" of such trading within First Jersey resulted in hundreds of thousands of dollars of profits and raises questions of violations of fiduciary obligations owed by brokers to their customers as well as other established rules and ethical concepts which govern the securities industry.

There is no question but that the facts discovered by the NASD staff constituted the administrative equivalent of "probable cause" for NASD to commence a disciplinary proceeding. It is also significant that on May 17, 1979, during the pendency of the proceedings in the district court, the SEC commenced a separate enforcement action on the basis of some of the same facts discovered by NASD against First Jersey, Robert Brennan and some



of the other Petitioners herein alleging violations of the federal securities laws and SEC rules. (The NASD's complaint charged Petitioners with violations of NASD Rules of Fair Practice.)

On February 1, 1979 pursuant to the authority and responsibility vested by Congress in the NASD, the District Business Conduct Committee of NASD District 12 commenced a disciplinary proceeding against Petitioners to determine if they had engaged in prohibited conduct. The Petitioners (sometimes collectively referred to herein as "First Jersey") did not answer the NASD complaint but instead commenced this action on April 17, 1979 seeking damages and to permanently enjoin the NASD from deciding the issues raised in its disciplinary proceeding. The jurisdiction of the district court was claimed under 15 U.S.C. §78aa and 28 U.S.C. §1331.

Petitioners alleged that the NASD and Bergen were violating their federal and state Constitutional rights to due process, as well as rights to a fair procedure under the Maloney Act and under the Administrative Procedure Act, 5 U.S.C. §554. Petitioners made numerous allegations concerning the manner and means by which the NASD District 12 investigation was conducted and the procedure by which the administrative complaint was instituted and was to be considered.

It is Respondents' contention that Petitioners' Complaint is a sham and that suit was instituted solely to vex and to delay NASD's disciplinary proceedings against Petitioners.

On April 17, 1979, the same day the civil action was commenced by Petitioners herein, they sought and were

granted, on an *ex parte* basis, an order by the district court for early depositions of Respondents to commence the day after service of process. Subsequent orders of the district court on April 20 and 26 required NASD to deliver all its documents to the accounting firm of Peat, Marwick, Mitchell & Co. as "Custodian" on April 27 and to commence depositions May 1st. Pursuant to urging of the district judge, Respondents engaged independent counsel over the weekend of April 28-29.

Respondents moved on April 30 to stay or modify the extant discovery orders to provide time for counsel to become familiar with the case and to file motions to dismiss. The application was denied. On May 3 defendants moved for a stay of the district court's April 17 and April 30 orders pending an appeal. This application was denied on May 4.

The district court's orders for discovery disrupted and frustrated NASD's prosecution of its action against Petitioners. For example, Petitioners conducted seven days of oral examination of the NASD Staff Attorney responsible, in part, for the preparation and presentation of evidence at the pending NASD hearing. The district court's discovery orders and its further orders denying a stay of them were the subject of NASD's Petition for Writ of Mandamus on May 16, 1979 to the United States Court of Appeals for the Third Circuit (hereinafter "Court of Appeals"), which issued an order staying all discovery in the district court proceedings on May 21, 1979, pending consideration of the Mandamus application.

In the course of the proceedings in the district court, Petitioners were urged by NASD on numerous occasions to follow established NASD procedures (which the Court



of Appeals found were "replete with procedural safeguards" (p. 43a)) to challenge the purported "bias" of District 12 committee members. Petitioners refused to do so. Nevertheless, to nullify and render moot all of Petitioners' assertions of bias and prejudice, NASD *unilaterally* changed the panel of Petitioners' disciplinary hearing to one composed of members from NASD District 8 in Chicago.

Respondents duly moved before the district court for a dismissal of the Complaint. Petitioners thereafter filed an order to show cause seeking a preliminary injunction of the NASD hearing. The district court consolidated both applications and heard testimony in open court for three days commencing on May 30, 1979. Respondents submitted no testimony at the hearing, but the numerous affidavits filed by Respondents in the district court were incorporated into the record. On June 4, 1979, the district court entered an order denying both the motion to dismiss and the application for a preliminary injunction. A copy of the district court's bench opinion is in Petitioners Appendix at p. 5a. After weeks of Petitioners' inspection of Respondents' investigative files, seven days of oral examination of its staff attorney and three days of testimony in open court, Petitioners failed to establish their case for a preliminary injunction. Nevertheless, the district court refused to dismiss the Complaint so as to permit the NASD to fulfill its Congressional mandate by expeditiously prosecuting its action against Respondents.

The district court's decision sets forth eight "assumptions" as the basis for its denial of Petitioners' application for injunctive relief. Jurisdiction was retained by the district court to monitor compliance with its "assumptions." The denial of the injunction was ". . . without prejudice to any further application as may be justified

in the event that the stated and implied assumptions may be frustrated." (slip opinion, p. 29a). Compliance with the district court's views was clearly expected. With respect to Respondents' motion to dismiss, the court stated that a stay or dismissal might be appropriate at some point "[i]f the court's assumptions prove to be correct . . ." (p. 29a).

The "assumptions", never previously suggested to the district court by NASD, touched upon critical issues such as selection of staff members to handle prosecution of NASD's disciplinary proceeding (assumption number one) and the time at which NASD would undertake processing of its disciplinary proceeding (assumption number five). The court "assumed", for example, that NASD proceedings would not commence until after the SEC had completed its hearings notwithstanding the fact that no SEC hearings had been scheduled and the date of their completion was wholly unknown.

The eight assumptions coupled with the stated purpose of the retained jurisdiction constituted a clear invitation to Petitioners to return to the district court if the assumptions were not borne out during the NASD disciplinary proceedings. The problem facing NASD could not have been more real. In order to properly fulfill the obligations of its Congressional charter, the NASD faced the prospect of defying the expressed views of the district court. But the unusual ruling by the district court precluded any direct appeal to the Court of Appeals. The NASD, in good faith, then advised the district court by letter of June 12, 1979 of its position that some of the assumptions were inaccurate. Respondent NASD had virtually no chance of completing its proceedings in a expeditious, efficient manner as is required to protect the public interest.



On June 7, 1979, NASD applied to the district court for an order amending the denial of Petitioners' motion to dismiss to include a certification pursuant to 28 U.S.C. §1292(b). This application was denied on June 12, 1979. Respondents then filed a second Petition for Writ of Mandamus to the Court of Appeals based upon the district court's ruling and its effect. Both Petitions were consolidated, substantial briefs on the Petitions were filed and oral argument was heard by the Court of Appeals, which on August 29, 1979 granted one of NASD's Petitions and ordered the district court to dismiss the case for lack of jurisdiction (Judgment, p. 61a; Writ of Mandamus, p. 63a).

The Court of Appeals' ruling was based on (1) the district court's failure to follow the doctrine of exhaustion of administrative remedies *and* (2) the district court's unwarranted intrusion into the agency proceeding itself.

## *REASONS FOR DENYING THE WRIT*

### I.

**The Writ of Mandamus was properly issued by the Court of Appeals to correct a usurpation of power by the District Court.**

Petitioners contend that the Writ of Mandamus issued because the district court failed to dismiss the action upon Respondents' motion. By contending that the district court had discretion to apply or reject the doctrine of exhaustion of administrative remedies, Petitioners create a false conflict with this Court's instruction in *Will* v. *Calvert Fire Insurance Co.*, 437 U.S. 655 (1978). In so doing, Petitioners both err and mislead this Court.

The Court of Appeals decision carefuly enunciated a *two-step* analysis in determining whether a Writ of Mandamus should issue. It is only the first part of that analysis, the discussion of the role of exhaustion of administrative remedies, that Petitioners cite. They ignore the second and equally determinative portion of the Court of Appeals opinion (commencing at p. 55a) which addressed whether, having determined error by the district court, the *attendant circumstances and actions* by the district court warranted mandamus. The Court of Appeals, with good reason, found that the district court's action exceeded its authority. As the Court of Appeals stated:

> "We believe, however, that the strict requirements for mandamus have been met in this case. NASD, in an effort to carry out its designated duty of enforcing the regulations of over-the-counter securities dealers, instituted a disciplinary proceeding against First Jersey. First Jersey attempted to block this effort by filing suit in district court. Because of the Company's failure to exhaust administrative remedies, the district court was without jurisdiction and should have dismissed the suit. Instead the court allowed discovery to proceed, which burdened NASD sufficiently to effectively halt the action against First Jersey. The court, although denying First Jersey's request for preliminary relief, did so on the basis of certain assumptions. It retained jurisdiction over the suit and *invited the company to return to court in the event any of the assumptions proved to be unfounded,* which NASD states is the case as to some of the assumptions. *This has the forceful effect of an injunction but precludes appellate review.* Thus, NASD lacks an alternative means of obtaining adequate relief. The district court's exercise of jurisdiction where none exists *and forecloseing appellate review* results in substantial interference with a congressionally mandated administrative process and amounts to a judicial usurpation of power.
>
> * * *
>
> . . . We hold that when the district court impermissibly *interferes with the legitimate operation of a federal administrative agency,* the agency is entitled to the issuance of a writ of mandamus to halt the judicial usurpation of power."



Slip Op., pp. 56a-57a (Emphasis added).

It is one thing to allow, for sound reasons of policy, a jurisdictional question to abide the normal events leading to appellate review. It is quite different, and substantially adverse to those same policy considerations, to permit improper jurisdiction to result in a forum in the district court from which a respondent in an agency proceeding can "broadside" the agency and its personnel to the inevitable frustration of the agency's Congressional charter and mandate.

## II.

**The District Court had no discretion to retain jurisdiction under controlling decisions.**

The Court of Appeals correctly rejected the Petitioners' contention that once *any* discretion by the district court is involved, mandamus under *Calvert* is simply not available under any circumstances. This Court's decision in *Calvert* was premised upon the inherent discretion of a district court in the control of its calendar, which discretion was held to have precluded an applicants' "clear and indisput-

able" right to a Writ of Mandamus. 437 U.S. 665-666. The Court of Appeals herein noted the great difference in the *degree* of discretion applicable between calendar control by the district court and a decision not to follow the well-estabilshed doctrine of requiring a party to exhaust his administrative remedies. The Court of Appeals stated the recognized rule that the doctrine *is to be followed* (Slip Op. pp. 43a-46a) except in two special situations not applicable to Petitioners.[1]

NASD's Code of Procedure, which governs the conduct of disciplinary proceedings, sets forth specific procedures facilitating appellate review. The District Business Conduct Committees initially hear and pass upon all complaints. A written decision must be issued by the District Committee setting forth, *inter alia,* the act or practice in which the respondent has engaged, the specific rules violated, and the penalty imposed. Respondents are afforded a second level of consideration through a *de novo* hearing before a subcommittee of the NASD's Board of Governors and another level of review by the whole Board of Governors. In addition, respondent is informed that it has the right to appeal a final determination of the NASD to the SEC. Thus, procedural requirements for NASD disciplinary proceedings provide for two levels of hearings and a review at the NASD level, even before *de novo* review by the SEC.

15 U.S.C. §78o-3 sets forth a well reasoned and carefully considered scheme of securities industry *self*-regulation under the supervision of the SEC. The rules of NASD are subject to SEC review and approval before

[1] The appellate court decision noted this Court's decisions in *Myers* v. *Bethlehem Shipbuilding Corp.,* 303 U.S. 41, 50-51 (1938) and *McKart* v. *United States,* 395 U.S. 185, 193 (1969).



they become effective and in the later course of their application in specific proceedings. Review of NASD proceedings by the SEC is set by statute, 15 U.S.C. §78 s(d)(2) as is the subsequent *judicial* review of any SEC determination by the Court of Appeals. 15 U.S.C. §78y(a)(1).

Petitioners contend that 15 U.S.C. §78aa vests a district court with *exclusive* jurisdiction for purported Exchange Act violations *including Petitioners' claims* against the NASD. This erroneous view would have the jurisdictional provisions of 15 U.S.C. §78aa (which, as the Court of Appeals noted, provide for district court jurisdiction for substantive violations of the act in suits by the SEC or private parties) used to entertain allegations of procedural irregularities of any type in derogation of the statutory scheme of administrative overview and Court of Appeals jurisdiction to correct infirmities where they exist. The consequence of Petitioners' assertion would enable *any* respondent in *any* administrative proceeding to delay and frustrate the proceeding by commencing suit in a district court alleging procedural irregularity.

In this regard, it is significant that the Securities Act Amendments of 1975 made substantial additions to 15 U.S.C. §78y, expressly placing judicial review of SEC *rules* in the Courts of Appeals under the Exchange Act, rather than with the district courts under the Administrative Procedure Act, 5 U.S.C. §702. As noted in the Report of the Senate Committee accompanying the 1975 Amendments to the 1934 Act:

> "Industry organizations, *i.e.,* the exchanges and the NASD are delegated governmental power in order to enforce, at their own initiative, compliance by members of the industry with both the legal requirements laid down in the Exchange Act and ethical standards going beyond those requirements.

> *The SEC is charged with supervising the exercise of this self-regulatory power in order to assure that it is used effectively to fulfill the responsibilities assigned to the self-regulatory agencies, and that it is not used in a manner inimical to the public interest or unfair to private interests".* S. Rep. No. 94-75, 94th Cong., 1st Sess. 22-23 (1975) [emphasis added].

In further noting that the self-regulatory organizations exercise authority subject to SEC oversight, the Report states:

> "The self-regulatory roles of the exchanges and the NASD have been major elements of the regulatory scheme of the Exchange Act since 1934 and 1938, respectively. Although self-regulation has not always performed up to expectations, on the whole it has worked well and the Committee believes it should be preserved and strengthened. S. 249 is designed to accomplish this, not only by clarifying regulatory responsibilities at all levels but also by *assuring that the self-regulatory organizations follow effective and fair procedures*, that their activities are not anti-competitive and that the Commission's oversight powers are ample *and its responsibility to correct self-regulatory lapses is unmistakable*. The intent of this bill is not to diminish the role of self-regulation but to strengthen the total regulatory fabric." *Id.* at 23. [emphasis added].

The Senate Committee Report, in considering the necessity for self-regulatory procedures to adhere to due process, and the Commission's duty to insure that these procedures operate in a manner consistent with due process requirements, noted:



> "Recognizing that the self-regulatory organizations utilize governmental-type powers in carrying out their responsibilities under the Exchange Act highlights the fact that these organizations must be required to conform their activities to fundamental standards of due process.
>
> The Exchange Act presently requires that the NSAD's disciplinary actions be conducted in accordance with rules which provide "a fair and orderly procedure," including the obligation that the self-regulatory organization bring "specific charges," give notice, provide an opportunity for hearing, and identify in any adverse determination the act or practice which constitutes the violation of a "specific rule or rules." The Exchange Act also provides for Commission review of NASD disciplinary actions both on the Commission's own motion and by petition of an aggrieved person." Id. at 25.

The two separate jurisdictional provisions of the Exchange Act, 15 U.S.C. §§78y(a)(1) and 78aa, provide additional *statutory* support for either the *intended* application of the doctrine of exhaustion or a determination that the carefully spelled out regulatory and procedural scheme of the Exchange Act mandates the regulatory forum and removes any question of exhaustion from the district court's consideration.

## III.

**All other issues cited by petitioners are premature and may be addressed in the administrative forum and in the course of proper judicial review thereafter as required by statute.**

### A. Purported constitutional infirmities, inherent and specific cannot be decided in the abstract.

In their further efforts to block not only the instant NASD proceeding, but *any* such proceeding, Petitioners have raised the gamut of inherent and specific claims challenging the Constitutionality of the key aspects of the self-regulatory framework set by Congress in 1934, 1938 and most recently in 1975, when the concept was reviewed, re-approved and strengthened. (See Senate Committee on Banking, Housing and Urban Affairs Report No. 94-75, April 14, 1975, portions of which are quoted within II herein). Petitioners seek to make this challenge not only before any steps in the regulatory scheme have been taken, but also after refusing to avail themselves of the procedural safeguards afforded to them by the NASD. Petitioners' refusal even to seek a venue change from District 12 to District 8 (thereby *creating* an issue) needs no amplification. In addition, Section XXIII of the NASD Code of Procedure provides for the removal from hearing panels of any member who has a conflict. Petitioners did not attempt to utilize this provision.

Their novel contenion that industry membership is inherently incapable of self-discipline compatible with Constitutional guarantees would effectively abolish the self-regulatory scheme notwithstanding forty years of successful operation. Until Petitioners experience an adverse decision *in the course of such a proceeding*, they are



arguing only in the abstract. The administrative process herein has had no opportunity *at Petitioners' instance* to perceive, address, decide and, if necessary, correct any of the procedural shortcomings alleged.

The question presently before this Court is the propriety of *certiorari* to review the Court of Appeals' issuance of a Writ of Mandamus to the district court. That decision need not—and by common sense should not—be enlarged to consider abstract questions which no lower court or regulatory agency has considered.

The Court of Appeals' discussion of Petitioners' constitutional claims (pp. 48a-55a) was clearly not intended to be dispositive of such claims as they might *ultimately* be articulated by Petitioners if and when *future* facts, events and rulings occur. Rather, the Court of Appeals' discussion was in the context of Petitioners' failure to demonstrate *clear and unambiguous* Constitutional violation by the agency. In the case of *Todd & Co. v. SEC*, 557 F.2d 1008 (3d Cir. 1977) at page 1012 the Court of Appeals decided the question of unconstitutional delegation. As to the 1975 Amendment purportedly affecting the scope of SEC review, the Court of Appeals in the case below said:

> "We need not now decide whether this statutory change effects a significant alteration in the SEC's power to review NASD disciplinary proceedings. It suffices to say that to the extent the amendment restricts the SEC's ability to receive additional evidence not presented below, this does not alter our conclusion in Todd that there is no unconstitutional delegation of legislative authority". p. 49a (emphasis added).

Just as the limited consideration of Respondents' Petition for Writ of Mandamus before the Court of Appeals was deemed not the time to explore a purported Constitutional claim in depth, the within consideration of *certiorari* is not the appropriate time to address abstract issues and theoretical niceties. Likewise with respect to structural or specific bias, the Court of Appeals' opinion did not attempt to forestall all consideration of Petitioners' claims. The Court of Appeals properly determined only that it was neither the time nor the place to do so in the district court during the pendency of the agency proceeding.

Petitioners' invitation, to dismantle the foundation of the Exchange Act upon no record and no prior ruling (administrative or judicial) on the within facts, should be declined.

**B. Exhaustion of administrative remedies, State v. Federal considerations.**

Petitioners assert that different standards presently control the doctrine of exhaustion of administrative remedies as applied to federal or state regulatory agencies. The genesis of this assertion is the Court of Appeals' careful distinction, in the decision below, of *Gibson* v. *Berryhill*, 411 U.S. 564 (1973), which concerned a state regulatory agency, and the instant case which concerns a federal regulatory scheme. As the Court of Appeals properly noted, *Gibson* was an action under 42 U.S.C. §1983 and this Court held that the "state administrative remedies need not be exhausted where the federal court plaintiff states an otherwise good cause of action under 42 U.S.C. §1983." (p. 52a). Petitioners misinterpret a ruling on the application of §1983 as a decision on the standards for application of the doctrine of exhaustion. While there



may be instances where §1983 *precludes* application of the doctrine, it does not vary the standards of application. What Petitioners really seek is a ruling from this Court on the scope and effect of §1983 in the instant case wherein no §1983 claim is made. Petitioners invitation for such a ruling should be denied.

## CONCLUSION

**For these reasons, a writ of certiorari to review the judgment and opinion of the Court of Appeals should be denied.**

Respectfully submitted,

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